18960590.LOF

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 96-0590 FIT
Financial Institutions Tax
For Tax Periods: 1992 Through 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Financial Institutions Tax: Adjusted Gross Income-Bad Debts

Authority: IC 6-5.5-2-1, IC 6-5.5-1-2

Taxpayer protests the treatment of bad debts in the audit.

II. Financial Institutions Tax: Apportionment-Receipts Factor

Authority: IC 6-5.5-2-4

Taxpayer protests the determination of receipts attributable to Indiana.

III. Financial Institutions Tax: Mortgage Backed Securities

Authority: IC 6-5.5-4-4-IC 6-5.5-4-13, IC 6-5.5-4-15 (1990)

Taxpayer protests the assessment of tax on mortgage backed securities.

IV. Financial Institutions Tax: Loan Fee Income

Authority: IC 6-5.5-4-4

Taxpayer protests the method of assigning loan fee income to Indiana.

V. Financial Institutions Tax: Nexus

Authority: IC 6-5.5-3-1

Taxpayer protests the determination that they have sufficient Nexus with Indiana to subject them to the Financial Institutions Tax.

STATEMENT OF FACTS

Taxpayer was originally organized as a non-Indiana state chartered savings and loan association in 1889, converted to a federally chartered savings and loan association in 1981 and converted to a federally chartered savings bank in 1991. Taxpayer is a wholly owned first tier subsidiary of a another foreign corporation. Taxpayer is regulated by the Director of the Office of Thrift Supervision and the Federal Deposit Insurance Corporation which, through the Savings Association Insurance Fund and the Bank Insurance Fund, insures the deposit accounts of Taxpayer. Taxpayer is further subject to regulations of the Board of Governors of the Federal Reserve System with respect to reserves required to be maintained against deposits. On February 26, 1993, the parent corporation's three FDIC insured federal savings banks, Taxpayer and its wholly owned subsidiaries and two other federal savings and loan associations merged into a single federal savings bank that operates as Taxpayer. The Department audited Taxpayer for the years 1992, 1993 and 1994. The audit includes on a unitary basis the total income of the Holding Company parent along with all subsidiary corporations. The audit resulted in an additional Financial Institutions Tax Assessment for those years. Taxpayer timely protested the assessment. Further facts will be provided as necessary.

DISCUSSION

FINANCIAL INSTITUTIONS TAX: ADJUSTED GROSS INCOME

Pursuant to IC 6-5.5-2-l, Indiana imposes a franchise tax on financial institutions. That tax is measured by the adjusted gross income or apportioned income of the financial institutions. Adjusted gross income is defined in IC 6-5.5-1-2 as taxable income as defined in IRC sec. 63 with several modifications. Included in those modifications is IC 6-5.5-1-2(5) which adds an amount equal to a deduction allowed or allowable under Section 166, Section 585 or Section 593 of the Internal Revenue Code. Taxpayer protested the Auditor's method of computing the deduction. In this computation, the auditor started with Taxpayer's taxable income per the federal return on a consolidated basis. The auditor then subtracted the qualifying dividend deduction taken from the federal return. She then added back the bad debt deduction from line 15 of Taxpayer's federal return. The difference between the add back and the Sec.166 (a) IRC Deduction is the reserve bad debts that cannot be deducted. The auditor properly excluded this amount in the computation of the tax due.

Taxpayer also contends that the auditor did not deduct the bad debts of the non-thrifts. The auditor is instructed to reexamine the taxpayer's records and determine if she failed

to deduct the bad debts of any qualified non-thrifts. Any qualified non-thrift deductions should be deducted in the computation of adjusted gross income. A qualified non-thrift would be any subsidiary company that does not receive at least 80% of its gross income, excluding extraordinary income, from the extension of credit. Activities related to the extension of credit include loaning money, servicing loans, financial leases (income not treated as rent for Federal Income Tax purposes) or operating a credit card business.

FINDING

Taxpayer's protest is denied in part and sustained in part subject to verification.

FINANCIAL INSTITUTIONS TAX: APPORTIONMENT-RECEIPTS FACTOR

IC 6-5.5-2-4 provides that if a taxpayer files a combined return for its unitary group, the group's apportioned income consists of:

"(1) the aggregate adjusted gross income, from whatever source derived, of the resident taxpayer members of the unitary group and the nonresident members of the unitary group; multiplied by
(2) the quotient of:

(A) all the receipts of the resident taxpayer members of the unitary group from whatever source derived plus the receipts of the nonresident taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by
(B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions."

The auditor used gross income from the unitary group as reported on the consolidated federal return adjusted for Indiana as the starting point for determining apportioned income for Indiana. However, for the divisor of the above quotient described in (B) the auditor used total receipts of Taxpayer. Taxpayer contends that the auditor neglected to include the receipts of the other members of the unitary group. In the audit, because Taxpayer was the original filer, this amount was picked up in error. The auditor is instructed to adjust the denominator factor to include all unitary receipts.

FINDING

Taxpayer's protest is sustained.

FINANCIAL INSTITUTIONS TAX: MORTGAGE BACKED SECURITIES

Taxpayer also protests the inclusion of income from mortgage backed securities in the receipts attributable to Indiana in the apportionment factor. Taxpayer owns mortgage backed securities that are issued mostly by FNMA, FHLMC and some private issuers. Taxpayer does not own the underlying loan, nor does it receive interest on the loan from

the borrower. It receives interest from the company that issues the security. IC 6-5.5-4-4 through IC 6-5.5-4-13 enumerate the receipts that must be included in the dividend of the quotient of the computation to determine which receipts are attributable to transacting business in Indiana. Mortgage backed securities are not included in that listing. Therefore, all mortgage backed securities receipts are not attributable to Indiana. The Department is obligated to use a reasonable method to apportion the receipts and attribute the Indiana receipts to Indiana. In this case, Taxpayer's workpapers indicate which mortgage backed securities relate directly to Indiana. The Department assessed tax only on those receipts specifically related to Indiana as shown in Taxpayer's documents.

FINDING

Taxpayer's protest is denied.

FINANCIAL INSTITUTIONS TAX: LOAN FEE INCOME

The Department and Taxpayer agree that pursuant to IC 6-5.5-4-4 the loan fee income attributable to Indiana is subject to the Financial Institutions Tax. Taxpayer protests the method the auditor used to assign loan fee income to Indiana. The auditor used a percentage based on Taxpayer's workpapers indicating loan income related to property in Indiana. This was an appropriate method to determine the tax liability.

FINDING

Taxpayer's protest is denied.

Financial Institutions Tax: Nexus

Taxpayer's final point of protest concerns whether or not nexus exists to properly allow Indiana to impose the Financial Institutions Tax in this situation. Taxpayer contends that the Commerce Clause of the United States Constitution prohibits the imposition of the Financial Institutions Tax. An administrative hearing in the Indiana Department of Revenue is not the proper forum to challenge the constitutionality of the Indiana Financial Institutions Tax. IC 6-5.5-3-1 establishes an economic requirement for determining if a taxpayer has sufficient nexus to subject them to the Indiana Financial Institutions Tax. Taxpayer meets the criteria of this test for nexus. Taxpayer regularly solicits business from potential customers in Indiana and regularly sells products or services (mortgage loans) to customers in Indiana who receive the product or service in Indiana. Pursuant to this statute, taxpayer has a sufficient nexus with Indiana to allow the imposition of the Indiana Financial Institutions Tax.

FINDING

Taxpayer's protest is denied.